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Interest or Principles?: The Legal Challenge to IOLTA in Washington State

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INTEREST OR PRINCIPLES?: THE LEGAL CHALLENGE TO IOLTA IN WASHINGTON STATE

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Abstract: Interest on Lawyer Trust Accounts (IOLTA) programs exist in all fifty states and raise significant funding for legal services for the poor. A recent series of federal court lawsuits seeks to eliminate IOLTA programs on the grounds that they violate the Fifth and First Amendments to the U.S. Constitution. *Washington Legal Foundation v. Legal Foundation of Washington*, currently on appeal to the Court of Appeals for the Ninth Circuit, is one such lawsuit challenging Washington State's IOLTA program. In *Phillips v. Washington Legal Foundation*, a similar case from Texas, the U.S. Supreme Court recently ruled that funds raised through IOLTA represent "property" for the purposes of Fifth Amendment takings analysis. The *Phillips* ruling gives new momentum to the ongoing constitutional challenges to IOLTA. This Comment examines *Legal Foundation of Washington* in light of the Supreme Court's holding in *Phillips* and argues that the constitutional challenge to Washington's IOLTA program is without merit and should be rejected by the Court of Appeals for the Ninth Circuit.

It is a basic tenet of our constitutional system that all citizens are entitled to "the equal protection of the laws."[1] Yet in America today, eighty percent of the legal needs of low-income people are unmet.[2] IOLTA programs seek to address this disturbing situation.

IOLTA stands for Interest on Lawyer Trust Accounts and is a mechanism by which states fund legal aid programs for the poor. IOLTA programs are the second largest source of funding for indigent legal services, providing basic civil legal assistance for an estimated 1,700,000 people each year.[3] IOLTA plays an indispensable role in the legal services system, helping to protect basic civil rights for the poor in America.

A recent series of federal court lawsuits has challenged IOLTA programs, claiming that IOLTA violates both the Fifth and the First Amendments to the U.S. Constitution. These suits, which seek to eliminate IOLTA programs, have been brought by a conservative legal activist organization from Washington, D.C., the Washington Legal Foundation. In *Phillips v. Washington Legal Foundation*,[4] the

1. U.S. Const. amend. XIV, § 1.

2. *See* David Barringer, *Downsized Justice*, A.B.A. J., July 1996, at 60, 62.

3. *See* W. Frank Newton & James W. Paulsen, *Constitutional Challenges to IOLTA Revisited*, 101 Dick. L. Rev. 549, 550 (1997).

4. 524 U.S. 156 (1998).

Washington Legal Foundation sued the IOLTA program in Texas.[5] That suit resulted in a key ruling from the U.S. Supreme Court, holding that the funds raised through IOLTA represented "property" for the purposes of Fifth Amendment takings analysis.[6] In *Washington Legal Foundation v. Legal Foundation of Washington*,[7] the Washington Legal Foundation has also sued the IOLTA program in Washington State, and the case is currently on appeal in the Ninth Circuit.[8]

This Comment analyzes *Legal Foundation of Washington* in the context of prior legal challenges to IOLTA and examines particularly the U.S. Supreme Court decision in *Phillips*. Part I discusses the importance of IOLTA programs and their history across the nation and in Washington State. Part II establishes the legal context for the recent IOLTA lawsuits, and Part III discusses the previous legal challenges to IOLTA. Part IV analyzes *Legal Foundation of Washington* and concludes that Washington's IOLTA program does not violate Fifth or First Amendment protections.

I. THE IMPORTANCE AND HISTORY OF IOLTA

A. The Importance of IOLTA

IOLTA works by requiring attorneys to pool small or short-term client deposits into special IOLTA bank accounts. The interest earned on these accounts is then used to fund legal services programs. By pooling these small and otherwise unproductive deposits, IOLTA generates approximately $100 million dollars per year nationally.[9] The money is used to provide legal assistance for battered women, migrant farm workers, and immigrants seeking political asylum, among others.[10] Because of the reduction in funding of legal aid from other sources,

5. *See id.* at 156.

6. *See id.* at 172.

7. No. C-97-0146C (W.D. Wash. Jan. 30, 1998). The Washington Legal Foundation is a Washington, D.C., legal activist organization that is suing IOLTA programs across the country. The Legal Foundation of Washington is the agency in Washington State that distributes IOLTA funds.

8. *See id.* (order granting defendants' motion for summary judgment).

9. *See* Brent Salmons, *IOLTAs: Good Work or Good Riddance?*, 11 Geo. J. Legal Ethics 259, 259 (1998).

10. For an example of the types of programs funded by IOLTA, see Legal Found. of Wash., *Welcome to the Legal Foundation of Washington's Grants Section* (visited Sept. 20, 1999) <http://www.legalfoundation.org/grants.htm>.

IOLTA has grown in importance as a source of financial support for these services.[11]

Unlike IOLTA funds, other sources of legal-aid funding suffer from onerous restrictions.[12] The federal government distributes approximately $300 million per year to legal aid programs through the Legal Services Corporation (LSC).[13] However, the federal government limits how LSC funds are spent, preventing programs from serving migrant farm workers, Native American groups, residents of juvenile and adult correctional facilities, and other groups.[14] The LSC also restricts the kinds of advocacy that programs can provide, prohibiting, among other things, class action suits and welfare reform challenges.[15] Because IOLTA funds are not as limited, they fill important gaps left by the federal restrictions.

Even with IOLTA, the total of federal and state funds currently spent on legal services is woefully inadequate to meet the legal needs of disadvantaged people in America.[16] At current funding levels, eighty percent of the legal needs of low-income people go unmet.[17] The potential end of IOLTA programs looms as a disaster for the legal rights of the poor in America.

B. IOLTA's History

In effect, IOLTA converts funds that were formerly provided to banks as unearned windfall profits to beneficial social use. IOLTA exists as an outgrowth of federal banking law. Before IOLTA, attorneys often held small sums of client money, or larger sums for short periods of time, in pooled trust accounts.[18] Ethical rules required lawyers to maintain client

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11. *See* Salmons, *supra* note 9, at 264.

12. *See* Access to Justice Bd., Washington State Bar Ass'n, *Plan for the Delivery of Civil Legal Services to Low-Income People in Washington State* 2 (rev. ed. Nov. 1995) [hereinafter *Plan for Civil Legal Services*].

13. *See* James C. Moore, *Congress Right to OK $300 Million for Legal Services*, Times Union (Albany), Nov. 9, 1998, at A10.

14. *See Plan for Civil Legal Services*, *supra* note 12, at 3.

15. *See id.*

16. *See* Barringer, *supra* note 2, at 62.

17. *See id.*

18. *See* Salmons, *supra* note 9, at 260; *see also* Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962, 968 (1st Cir. 1993).

funds so that the money was immediately available for withdrawal.[19] However, federal banking regulations did not allow checking accounts to earn interest, and this restriction prevented these pooled accounts from earning interest.[20] Banks that held these funds could invest and earn interest on them.[21] Therefore, before IOLTA, these pooled client accounts "amounted to interest-free loans to banks."[22]

In 1980, changes in federal banking law created negotiable order of withdrawal (NOW) accounts, or interest-bearing checking accounts.[23] It became possible to pool small or short-term client deposits into checking accounts and theoretically earn interest for the individual depositors.[24] However, banks had to "sub-account" such pooled accounts to track each depositor's interest.[25] Consequently, the costs of setting up and administering such accounts exceeded the interest that individual depositors earned.[26] Also, ethical rules prohibited attorneys from charging fees for administering pooled NOW accounts, and administration time was nonbillable.[27] As a result, attorneys did not use NOW accounts to earn interest for client depositors.[28]

Because nonprofit organizations and public entities may use NOW accounts,[29] IOLTA programs create eligible nonprofit organizations and make them the sole recipients of the interest produced by the pooled trust funds.[30] By designating all of the interest to one recipient, sub-accounting costs are avoided and the interest earned exceeds the costs of administering the account.[31] IOLTA programs allow these monies, which cannot earn net interest for the individual depositors, to earn net interest for a nonprofit foundation. The nonprofit foundation then distributes these funds to legal services programs.

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19. *See* Cone v. State Bar, 819 F.2d 1002, 1005 (11th Cir. 1987).

20. *See Massachusetts Bar Found.*, 993 F.2d at 968.

21. *See Cone*, 819 F.2d at 1005.

22. Salmons, *supra* note 9, at 261.

23. *See* Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 303, 94 Stat. 132, 146 (1980) (codified as amended at 12 U.S.C. § 1832 (1994)).

24. *See* Salmons, *supra* note 9, at 261.

25. *See Cone*, 819 F.2d at 1006.

26. *See id.*

27. *See* Salmons, *supra* note 9, at 260–61.

28. *See id.* at 261.

29. *See* 12 U.S.C. § 1832(a)(2) (1994) (discussing depositors eligible to use NOW accounts).

30. *See Cone*, 819 F.2d at 1006.

31. *See id.*

Florida instituted the first American IOLTA program in 1981.[32] Since then, all fifty states have authorized IOLTA programs either through court rule or by statute.[33] Although Florida originally enacted a voluntary program, IOLTA programs are now mandatory in twenty-seven states.[34]

IOLTA rules require all attorneys who receive client funds to determine whether the funds are IOLTA eligible.[35] Only funds that are nominal, or are to be held for a short period of time, are pooled into IOLTA accounts.[36] If a client deposit is large enough or will be held long enough to earn net interest for the client, it does not qualify for IOLTA.[37]

C. IOLTA's Development in Washington State

In 1984, the Supreme Court of Washington created Washington's IOLTA program.[38] The state legislature has delegated authority to the state supreme court to regulate the activities of the legal profession through control over the Rules of Professional Conduct (RPC).[39] Pursuant to this authority, the court created IOLTA by approving RPC 1.14, which requires lawyers in Washington to use IOLTA accounts for client deposits when appropriate.[40] When a lawyer receives client funds incident to a legal transaction, he or she must determine if the "funds [could] be invested . . . to provide a positive net return to the client."[41] If

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32. *See* Katherine Elrich, *Equal Justice Under the Law, (If You Can Afford It): Fifth Circuit Threatens Texas' IOLTA Program*, 28 Tex. Tech L. Rev. 887, 894 (1997).

33. *See* Gill Deford et al., *The Supreme Court's 1997–1998 Term: The Texas Interest on Lawyers Trust Account Case and Others Affecting Access to Justice*, Clearinghouse Rev., Nov.–Dec. 1988, at 287, 288 n.4.

34. *See* Salmons, *supra* note 9, at 263.

35. *See, e.g.*, Wash. Rules of Professional Conduct Rule 1.14(c)(3) (1999).

36. *See* Elrich, *supra* note 32, at 893.

37. *See* Wash. Rules of Professional Conduct Rule 1.14(c)(3).

38. *See* Wash. Rules of Professional Conduct Rule 1.14 (1999). The provision that created IOLTA in Washington, RPC 1.14, was proposed by the Washington State Bar Association in 1981 and approved by the state supreme court in 1984. *See* Supreme Court of Washington, IOLTA Adoption Order, 1101–15 (June 19, 1984) [hereinafter IOLTA Adoption Order].

39. *See* Wash. Rev. Code § 2.48.060 (1998); *see also* Wash. General Rule 9 (original rule effective Mar. 19, 1982, amendment effective Sept. 1, 1984). The Washington State Bar Association must first propose such rules. *See* Wash. General Rule 9 (outlining rule-making procedure for Supreme Court of Washington).

40. *See* Wash. Rules of Professional Conduct Rule 1.14(a).

41. Wash. Rules of Professional Conduct 1.14(c)(3). Three factors are considered: the amount of interest the funds would generate, the costs of administering the account (including the costs of the

the client cannot earn a positive net return, the funds are deposited in an IOLTA account, and the interest is paid to the Legal Foundation of Washington (the Foundation).[42] The Foundation disburses these funds to legal services programs throughout Washington.

1. The Limited Practice Officer Program and IOLTA

In 1995, Washington State's IOLTA regime broadened to include Limited Practice Officers (LPOs). Since 1983, Washington State has authorized nonlawyers, as LPOs, to "select, prepare and complete legal documents incident to the closing of real estate and personal property transactions."[43] LPOs may provide these legal services to title companies, banks, mortgage companies, and lawyers.[44] Use of LPOs reduces transaction costs because an attorney is not required to complete routine legal documents.

The rule authorizing LPOs to perform certain legal services did not require them to participate in IOLTA.[45] Although the rule-making processes that created LPOs and IOLTA proceeded in tandem, the drafters of the LPO provisions overlooked the potential to include LPO transactions within IOLTA.[46] In 1995, after much debate, the Supreme Court of Washington resolved this issue by modifying Admission to Practice Rule (APR) 12(h) and adopting APR 12.1, which established that title and escrow transactions facilitated by LPOs are covered by IOLTA rules.[47] This addition significantly boosted overall IOLTA funding.[48]

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lawyer's services), and the capability of the financial institution to calculate and pay interest to individual depositors. *See* Wash. Rules of Professional Conduct Rule 1.14(c)(3)(i)–(iii).

42. *See* Wash. Rules of Professional Conduct Rule 1.14(c)(1).

43. Wash. Admission to Practice Rule 12 (1999). The Admission to Practice Rules are subject to approval and modification by the Supreme Court of Washington on recommendation from the Washington State Bar Association. *See* Wash. General Rule 9. LPOs are licensed by the Limited Practice Board. *See* Wash. Admission to Practice Rule 12(b).

44. *See* Wash. Admission to Practice Rule 12(d).

45. *See* Board of Governors, Washington State Bar Ass'n, *GR 9 Cover Sheet: Proposal to Create New Admission to Practice Rules 12(h) and 12.1*, at 2 (1994).

46. *See id.*

47. *See* Wash. Admission to Practice Rule 12(h) (original rule effective Jan. 21, 1983; amendment effective Oct. 28, 1983; Sept. 13, 1985; Dec. 9, 1995); Admission to Practice Rule 12.1 (effective Dec. 9, 1995).

48. *See* Legal Found. of Wash., *supra* note 10 (providing year-by-year description of IOLTA proceeds received by Foundation).

2. *The Legal Foundation of Washington*

The Legal Foundation of Washington is the granting agency that distributes IOLTA money to civil legal services programs throughout Washington.[49] The Foundation currently funds thirty-six legal services programs.[50] In 1998, it distributed $6,149,773.[51] Columbia Legal Services received $4,200,000, funding eight offices throughout Washington.[52] Other programs receiving IOLTA funds included pro bono attorney systems in twenty-three Washington counties and several specialty legal services providers.[53] These programs aid migrant farm-workers, immigrant refugees, unemployed workers, battered women, and other disadvantaged groups.[54] The Foundation is also an integral member of the Washington State Access to Justice Network, which is a public-private partnership that seeks to coordinate efficiently civil legal services for low-income residents of Washington.[55]

3. *Legal Questions Posed by the Adoption of IOLTA in Washington*

Despite the significant benefits provided by IOLTA, there have always been pockets of opposition in the legal community. After the Washington State Bar Association proposed IOLTA in Washington, the Supreme Court of Washington received objections to the program during the rule making comment period.[56] These objections foreshadowed later legal challenges to IOLTA.

Some attorneys in Washington argued to the court that the IOLTA program constituted an unconstitutional taking of private property.[57] They argued that the U.S. Supreme Court's decision in *Webb's Fabulous Pharmacies, Inc. v. Beckwith*[58] stood for the "broad general proposition

49. *See* Wash. Rules of Professional Conduct Rule 1.14 (1999).

50. *See* Legal Found. of Wash., *supra* note 10.

51. *See id.*

52. *See id.*

53. *See id.*

54. *See id.*

55. *See* Legal Found. of Wash., *Home Page* (visited Sept. 20, 1999) <http://www.legalfoundation.org>.

56. *See* IOLTA Adoption Order, *supra* note 38, at 1101 ("The court received 531 public comments, 424 of which (80 percent) supported the proposed IOLTA program."). Any proposed change to the rules governing the legal profession must be published for comment before it is adopted. *See* Wash. General Rule 9(f) (1999).

57. *See* IOLTA Adoption Order, *supra* note 38, at 1104–09.

58. 449 U.S. 155 (1980).

that interest is property."[59] In *Webb's*, originally a Florida case, a corporate plaintiff filed an interpleader action to enforce a contract to purchase Webb's Fabulous Pharmacies for $1,812,145.77.[60] In accordance with the rules of interpleader, the plaintiff deposited the disputed amount with the court clerk.[61] The court clerk collected a percentage fee for services rendered on the fund,[62] and Florida law also allowed the court to keep all of the interest earned on the deposit, which amounted to over $100,000.[63] Webb's sued to recover this amount from the clerk and claimed that confiscation of the interest proceeds was an unconstitutional taking.[64] On appeal, the U.S. Supreme Court agreed with the plaintiffs in a narrowly tailored holding:

> We hold that under the narrow circumstances of this case—where there is a separate and distinct state statute authorizing a clerk's fee "for services rendered" based upon the amount of principal deposited[,] . . . the interest earned on the interpleader fund while it was in the registry of the court was a taking violative of the Fifth and Fourteenth Amendments.[65]

In 1984, the Supreme Court of Washington, in its IOLTA Adoption Order, distinguished *Webb's* and rejected the claim that IOLTA represented an unconstitutional taking of the private property of deposit owners.[66] The court clarified that the only funds eligible under Washington's IOLTA program are funds that could not under any circumstances produce net interest payments for the client.[67] Given this distinction, the court concluded that *Webb's* was inapposite.[68] While *Webb's* involved two separate and large levies against a private fund,[69] IOLTA involves "small amounts of interest on nominal and short-term trust deposits."[70] A deposit of the size present in *Webb's* would not be

59. IOLTA Adoption Order, *supra* note 38, at 1107.
60. *See Webb's*, 449 U.S. at 156.
61. *See id.* at 157.
62. *See id.*
63. *See id.* at 156 n.1.
64. *See id.* at 158.
65. *Id.* at 164–65.
66. *See* IOLTA Adoption Order, *supra* note 38, at 1109.
67. *See id.* at 1101.
68. *See id.* at 1107.
69. *See id.*
70. *Id.*

eligible under the Washington IOLTA rule.[71] The Supreme Court of Washington concluded that the "interest on short-term or nominal client trust funds of the type that must be invested for the benefit of the Foundation . . . does not constitute 'property' as defined by the United States or Washington Constitutions."[72] Accordingly, the court adopted the rule creating Washington's IOLTA program.[73]

II. THE CONSTITUTIONAL CONTEXT OF IOLTA: FIFTH AND FIRST AMENDMENT CONSIDERATIONS

The constitutional implications of IOLTA programs have led to challenges to IOLTA in both state and federal courts. In *Legal Foundation of Washington*, the plaintiffs claim that IOLTA violates both the Fifth Amendment's takings clause and the First Amendment's freedom-of-association clause.[74] A violation of the Fifth Amendment's takings clause occurs when the government takes private property without just compensation.[75] A violation of the First Amendment's freedom-of-association clause occurs when an organization compels its members to financially support political activities that are unrelated to the goals of the organization.[76]

A. The Takings Clause of the Fifth Amendment Prohibits Government from Taking Private Property Without Just Compensation

The takings clause of the Fifth Amendment states: "No person shall be . . . deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use, without just compensation."[77] It applies to the states through the Fourteenth Amendment.[78] While courts have struggled to establish a consistent interpretation of the takings clause, general principles have emerged.

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71. *See* Wash. Rules of Professional Conduct Rule 1.14(c)(3)(i)–(iii) (1999).

72. IOLTA Adoption Order, *supra* note 38, at 1109.

73. *See id.* at 1115.

74. *See* Complaint for Injunctive Relief, Washington Legal Found. v. Legal Found. of Wash., No. C-97-0146C (W.D. Wash. filed Jan. 27, 1997).

75. *See* U.S. Const. amend. V.

76. *See, e.g.*, Keller v. State Bar, 496 U.S. 1, 13–14 (1990); Chicago Teachers Union Local No. 1 v. Hudson, 475 U.S. 292, 301–02 (1986).

77. U.S. Const. amend. V.

78. *See, e.g.*, Chicago, B & Q Ry. Co. v. Chicago, 166 U.S. 226, 239 (1897).

To prove an unconstitutional taking, claimants must first establish that a cognizable property right exists in the thing that they claim was taken.[79] Property rights are not defined by the U.S. Constitution but rather are created and defined by independent sources such as state law.[80] A takings claimant must identify credible sources, such as positive rules of substantive law, to validate the existence of a property interest.[81] A "unilateral expectation or an abstract need" does not constitute property.[82]

Takings jurisprudence provides no set formula for determining if a taking has occurred.[83] Courts engage in this inquiry in light of the Fifth Amendment's purpose, which is to establish a just and fair distribution of the social burdens that government action creates.[84] Takings analysis is essentially an "ad hoc, factual" inquiry.[85]

The U.S. Supreme Court has identified two general categories of takings: per se takings and regulatory takings.[86] Government action that deprives property owners of all productive use of property or physically invades property boundaries is often interpreted as a per se or categorical taking.[87] However, courts are often reluctant to apply per se takings analysis to the appropriation of money, because unlike real property, money is "fungible."[88] If government regulation is not considered a per se taking, courts must still consider whether a regulatory taking has occurred by evaluating three general factors: (1) the severity of the economic impact on the takings claimant; (2) the extent to which the

79. *See, e.g.*, Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 124–25 (1978).

80. *See, e.g.*, Board of Regents v. Roth, 408 U.S. 564, 577 (1972).

81. *See, e.g.*, Perry v. Sinderman, 408 U.S. 593, 601–02 (1972).

82. Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980).

83. *See Penn Central*, 438 U.S. at 124.

84. *See, e.g.*, Armstrong v. United States, 364 U.S. 40, 49 (1960).

85. *Penn Central*, 438 U.S. at 124.

86. *See, e.g., Penn Central*, 438 U.S. at 124 (regulatory taking); Hudson Water Co. v. McCarter, 209 U.S. 349, 355 (1908) (categorical taking).

87. *See, e.g.*, Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419, 426–27 (1982) (holding that law requiring landlords to allow placement of cable television appliances in apartment buildings constituted per se taking); Agins v. City of Tiburon, 447 U.S. 255, 260 (1980) (holding that regulation destroying all beneficial use of land is categorical taking); *Hudson Water Co.*, 209 U.S. at 355 (stating that if height restrictions render property totally useless, "the rights of property prevail over the other public interest").

88. *See, e.g.*, United States v. Sperry Corp., 493 U.S. 52, 62 (1989); Branch v. United States, 69 F.3d 1571, 1576 (Fed. Cir. 1995); Nixon v. United States, 978 F.2d 1269, 1284–85 (D.C. Cir. 1992); Commercial Builders v. City of Sacramento, 941 F.2d 872, 875 (9th Cir. 1991).

regulation interferes with investment-backed expectations; and (3) the character and benefits of the government regulation.[89] Under this analysis, if a regulation has a small economic impact but a large public benefit, the court is not likely to find a taking.[90]

B. The First Amendment Prohibits Compelled Financial Support for Political and Ideological Activities

An organization may violate the First Amendment right not to associate when it compels its members to provide financial support for political activities that are unrelated to the goals of that organization.[91] The First Amendment protects the right to speak and associate freely[92] and also protects the right not to speak or associate.[93] Accordingly, the U.S. Supreme Court has ruled that organizations that engage in expressive activities are limited in their ability to force members to support those activities financially.[94]

The U.S. Supreme Court has examined this issue in cases involving labor unions and state bar associations.[95] For example, compulsory union dues that are imposed as a condition of employment cannot be used for unrelated political activities without the consent of the dues-paying member.[96] Similarly, in *Keller v. State Bar*,[97] the Court established that compulsory bar association dues could be spent to regulate the legal profession and improve the administration of justice,[98] but could not be

89. *See Penn Central*, 438 U.S. at 124.

90. *See, e.g.*, Pennsylvania Coal v. Mahon, 260 U.S. 393, 413 (1922) ("Government could hardly go on if to some extent values incident to property could not be diminished without paying for every such change in the general law.").

91. *See, e.g.*, Keller v. State Bar, 496 U.S. 1, 13–14 (1990); Chicago Teachers Union Local No. 1 v. Hudson, 475 U.S. 292, 301–02 (1986).

92. "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances." U.S. Const. amend. I.

93. *See, e.g.*, Wooley v. Maynard, 430 U.S. 705, 714 (1977) ("The right to speak and the right to refrain from speaking are complementary components of the broader concept of 'individual freedom of mind.'") (quoting West Virginia Bd. of Educ. v. Barnette, 319 U.S. 624, 637 (1943)).

94. *See, e.g.*, *Keller*, 496 U.S. at 15–16; *Chicago Teachers Union*, 475 U.S. at 301–02; Abood v. Detroit Bd. of Educ., 431 U.S. 209, 212 (1977).

95. *See, e.g.*, *Keller*, 496 U.S. 1; *Chicago Teachers Union*, 475 U.S. 292.

96. *See Abood*, 431 U.S. at 235–36.

97. 496 U.S. 1 (1990).

98. *See id.* at 13–14.

spent for overtly political purposes such as advancing voter initiatives.[99] However, such activities will not usually run afoul of the First Amendment when they are related to the legitimate goals of the organization in question.[100]

The First Amendment prohibition may not apply to cases where there is no mandatory and substantial relationship beyond a financial contribution. In that circumstance, the objecting party would not personally be linked to the ideological activities of the organization.[101] The Court of Appeals for the First Circuit has held in an IOLTA context that to violate the First Amendment, a compelled relationship must go beyond financial support.[102] In the U.S. Supreme Court cases discussed above, the compelled financial support takes place in a broader context of compelled membership or association. In the bar dues case, all practicing lawyers are required to maintain membership in the association.[103] In the labor union cases, all union contributors are covered by the collective bargaining agreements.[104] Without this substantial forced relationship, the constitutional concerns over forced association are significantly reduced.[105]

Under the government speech doctrine, government agencies do not suffer the same First Amendment limitations on raising and spending funds when they engage in government activities, even if those activities have an ideological component.[106] Because government agencies must make important public policy decisions, they must be free to compel financial support from citizens and spend such funds freely, even on

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99. *See id.* at 16.

100. *See, e.g., Keller*, 496 U.S. at 15–16 (indicating that only activities of "political or ideological coloration which are not reasonably related to the advancement of [the] goals [of an organization]" implicate First Amendment).

101. *See* Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962, 979 (1st Cir. 1993).

102. *See Massachusetts Bar Found.*, 993 F.2d at 979; *see also* PruneYard Shopping Ctr. v. Robbins, 447 U.S. 74, 87–88 (1980).

103. *See Keller*, 496 U.S. at 16.

104. *See* Chicago Teachers Union Local No. 1 v. Hudson, 475 U.S. 292, 294 (1986); Abood v. Detroit Bd. of Educ., 431 U.S. 209, 212 (1977).

105. *See Massachusetts Bar Found.*, 993 F.2d at 979.

106. *See Keller*, 496 U.S. at 12–13 ("If every citizen were to have a right to insist that no one paid by public funds express a view with which he disagreed, debate over issues of great concern to the public would be limited to those in the private sector, and the process of government as we know it radically transformed."); *see also* United States v. Lee, 455 U.S. 252, 260 (1982).

controversial projects.[107] This power is essential to the operations of government.

Lastly, a state is permitted to encroach upon First Amendment rights when the encroachment is narrowly construed to serve a compelling state interest.[108] When a burden on a First Amendment right is closely related to a legitimate state interest and is narrowly tailored to serve that interest, some burden is permissible.[109] Courts evaluate such state action under a strict scrutiny standard.[110]

III. HISTORY OF LEGAL CHALLENGES TO IOLTA

Since their inception, IOLTA programs have been challenged on constitutional grounds in both state and federal courts. Until recently, court decisions had been universally favorable to IOLTA, holding that IOLTA proceeds did not constitute property for the purposes of the Fifth Amendment. However, in the 1998 case *Phillips v. Washington Legal Foundation*, the U.S. Supreme Court held that IOLTA proceeds did constitute private property within the meaning of the Fifth Amendment. Although the Court did not rule on whether Texas' IOLTA program effected an unconstitutional taking, the *Phillips* decision significantly altered IOLTA case law. The challenge to Washington State's IOLTA program will be decided within the new legal context created by *Phillips*.

A. Early Court Challenges Uphold the Constitutionality of IOLTA

In *Carroll v. State Bar*,[111] one of the earliest legal challenges to IOLTA, the Court of Appeals of California laid down reasoning for upholding IOLTA that was echoed in later cases.[112] The petitioner challenged California's IOLTA scheme on Fifth Amendment takings grounds.[113] Like the Supreme Court of Washington in 1984, the California court concluded that because IOLTA applied only to client

107. *See, e.g., Abood*, 431 U.S. at 259 n.13.

108. *See* Austin v. Michigan Chamber of Commerce, 494 U.S. 652, 657 (1990).

109. *See* Pacific Gas & Elec. Co. v. Public Utils. Comm'n, 475 U.S. 1, 19 (1986); *see also Massachusetts Bar Found.*, 993 F.2d at 977.

110. *See Massachusetts Bar Found.*, 993 F.2d at 977.

111. 166 Cal. App. 1193 (Cal. Ct. App. 1985).

112. *See id.* at 1205.

113. *See id.* at 1204.

deposits that could not earn net income for the client, depositors had no cognizable property interest in IOLTA proceeds.[114]

In *Cone v. State Bar*,[115] the Eleventh Circuit held that there was no cognizable property interest implicated by IOLTA, using reasoning similar to that in *Carroll*.[116] Florida, where *Cone* originated, was the first state to implement IOLTA and the first to face a federal suit.[117] The class action suit challenged IOLTA on Fifth Amendment takings grounds.[118] The lead plaintiff, who was the representative of a probated estate, sued over $2.25 in interest that had reverted to IOLTA.[119] The Eleventh Circuit held that because IOLTA deposits could not have earned net interest for the depositors, the class members had no property interest in those proceeds.[120]

B. *The Washington Legal Foundation Begins a Concerted Attack on IOLTA Programs*

Court challenges to IOLTA were significantly accelerated by the decision of one organization, the Washington Legal Foundation (WLF), to sue state IOLTA programs repeatedly in federal court. The WLF has been the lead plaintiff in every federal court lawsuit to challenge IOLTA in this decade.[121] The WLF has sought to convince the federal judiciary that IOLTA is illegal and to shut down IOLTA programs.[122] As a result,

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114. *See id.* at 1205. The court opined, in dicta:

> When the regulation is one which promotes the common good, even by adjusting the benefits and burdens of economic life, a compensable "taking" is less readily found than when there is a physical government invasion. Where the public good is great, and a "taking" is minimal, it is permissible.

See id. at 1206.

115. 819 F.2d 1002 (11th Cir. 1987).

116. *See id.* at 1007.

117. *See id.* at 1004.

118. *See id.*

119. *See id.*

120. *See id.* at 1007.

121. *See* Phillips v. Washington Legal Found., 524 U.S. 156 (1998) (Texas' IOLTA program); Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962, 979 (1st Cir. 1993) (Massachusetts' IOLTA program); Washington Legal Found. v. Legal Found. of Wash., No. C-97-0146C (W.D. Wash. Jan 30, 1998) (Washington's IOLTA program).

122. *See, e.g., Massachusetts Bar Found.*, 993 F.2d at 970 ("The plaintiffs ask for declaratory and injunctive relief to dismantle the operation of the mandatory IOLTA program.").

federal lawsuits challenging IOLTA have increased in both number and urgency.

The WLF is a politically conservative legal activist organization headquartered in Washington, D.C. The WLF styles itself as "the nation's preeminent center for public interest law advocating free-enterprise principles, limited government, property rights, and reform of the civil and criminal justice system."[123] The WLF acknowledges that it uses lawsuits as a tool to shape public policy along these conservative lines.[124] The National Board of Advisors for the WLF consists mostly of conservative Republican politicians who help the organization define its expressly political mission.[125]

The WLF, in cooperation with an attorney and an IOLTA depositor, began its attack on IOLTA by challenging the Massachusetts IOLTA program in *Washington Legal Foundation v. Massachusetts Bar Foundation*.[126] The WLF raised both Fifth and First Amendment challenges to the program.[127] In a creative twist on the takings claim, the WLF alleged that the property right violated by IOLTA was not the taking of the interest itself but a violation of the right to exclude others from the beneficial use of that interest.[128] In support, the plaintiffs cited cases dealing with the right to exclude others from real property.[129] One plaintiff also alleged that the IOLTA program violated his First

123. Washington Legal Found., *WLF's Mission and Goals* (visited Sept. 20, 1999) <http://www.wlf.org/mission.htm>.

124. *See id.* ("WLF is a unique institution with three essential cornerstone programs: shaping public policy through aggressive litigation and advocacy; publishing timely legal studies; and educating policy-makers and the public through extensive communications outreach.").

125. *See* Washington Legal Found., *Advisory Board List* (visited Sept. 20, 1999) <http://www.wlf.org/advisory.htm> (indicating that members include Bob Barr (R), U.S. Representative, Georgia; Dan Burton (R), U.S. Representative, Indiana; Charles Canady (R), U.S. Representative, Florida; Helen Chenoweth (R), U.S. Representative, Idaho; Tom DeLay (R), U.S. Representative, Texas; Jesse Helms (R), U.S. Senator, North Carolina; and Henry J. Hyde (R), U.S. Representative, Illinois); *see also* U.S. Senate, *Senators of the 106th Congress* (visited Sept. 20, 1999) <http://www.senate.gov/senators/index.cfm>; United States House of Representatives, *Official Alphabetical Listing of the House of Representatives of the United States* (visited Sept. 20, 1999) <http://clerkweb.house.gov/106/mbrcmtee/members/mbrsalph/oalmfram.htm>. The WLF receives funding from numerous conservative foundations, including the Carthage Foundation, which is chaired by Richard Scaife. *See* Carthage Found., *1998 Annual Report* (visited Sept. 20, 1999) <http://www.scaife.com/carthage.pdf>.

126. 993 F.2d 962 (1st Cir. 1993).

127. *See id.* at 969–70.

128. *See id.* at 974.

129. *See id.* (citing, *e.g.*, Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982); Kaiser Aetna v. United States, 444 U.S. 164 (1979)).

Amendment associational rights by forcing depositors and attorneys to support organizations whose actions "offend his political and ideological beliefs."[130] At the time, the First Amendment claim was a novel argument against IOLTA, and the WLF has continued to employ this claim in subsequent suits.[131]

The Court of Appeals for the First Circuit rejected the plaintiffs' Fifth Amendment argument and held that any right to exclude others from the beneficial use of IOLTA funds was an intangible right that is not cognizable as property under Fifth Amendment analysis.[132] Balancing the factors from regulatory takings analysis,[133] the court held that even if the right to exclude were cognizable, IOLTA would not constitute a taking of those interests.[134] The court stated that under traditional takings analysis, "[t]he government may impose regulations to adjust rights and economic interests among people for the public good."[135]

The court also rejected the plaintiffs' First Amendment claim[136] and distinguished IOLTA from the union and bar association cases in two ways. The court held that those cases contained "a connection between dissenters and the organization so that dissenters reasonably under[stood] that they [were] supporting the message propagated by the recipient organization."[137] The court saw no such relationship between IOLTA depositors and the IOLTA program.[138] The court also held that because depositors had no cognizable property interest in IOLTA proceeds, there was no money taken and therefore no First Amendment violation.[139] Because IOLTA required no connection, financial or otherwise, between depositors and IOLTA activities, the court held that there was no violation of the plaintiffs' First Amendment rights.[140]

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130. *Massachusetts Bar Found.*, 993 F.2d at 970. Apparently, the WLF and the other plaintiffs find the provision of legal services for the poor to be politically and ideologically offensive.

131. *See infra* Part III.D.

132. *See Massachusetts Bar Found.*, 993 F.2d at 975–76.

133. *See supra* Part II.A.

134. *See Massachusetts Bar Found.*, 993 F.2d at 974.

135. *Id.* at 974.

136. *See id.* at 976.

137. *Id.* at 979.

138. *See id.* at 980.

139. *See id.*

140. *See id.*

C. *The U.S. Supreme Court Holds That IOLTA Proceeds Are Property Cognizable Under the Fifth Amendment*

The WLF continued its attack on IOLTA in Texas. The Texas Supreme Court established its IOLTA program in 1984.[141] Originally voluntary, the Texas Supreme Court made participation mandatory in 1988.[142] In 1994, the WLF coordinated with a client depositor and an attorney from Texas to file suit in federal court claiming that Texas' IOLTA program violated the Fifth and First Amendments.[143]

In a departure from all state and federal precedent, the Fifth Circuit ruled that under Texas law, IOLTA depositors had a valid property interest in IOLTA proceeds for the purposes of takings and First Amendment analysis.[144] The court accepted the plaintiffs' argument that Texas adhered to the "interest follows principal" maxim,[145] even within the IOLTA context.[146] The court thus held that the interest proceeds generated by IOLTA constituted cognizable property.[147] In a limited ruling, the court remanded to the district court the ultimate question of whether IOLTA interfered with this property right enough to violate the Fifth or First Amendments.[148]

The Texas Equal Access to Justice Foundation, the agency that distributes Texas' IOLTA funds, appealed this decision to the U.S. Supreme Court, and certiorari was granted on the following question:[149]

> Is interest earned on client trust funds held by lawyers in IOLTA accounts a property interest of the client or lawyer, cognizable under the Fifth Amendment of the United States Constitution, despite the fundamental precept of IOLTA that such funds, absent

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141. *See* Elrich, *supra* note 32, at 895.

142. *See id.* at 896.

143. *See* Washington Legal Found. v. Texas Equal Access to Justice Found., 94 F.3d 996, 999 (5th Cir. 1996), *aff'd sub nom.* Phillips v. Washington Legal Found., 524 U.S. 156 (1998).

144. *See id.* at 1004.

145. *See supra* Part I.C.3.

146. *See Texas Equal Access to Justice Found.*, 94 F.3d at 1003. In support of the Fifth Circuit's analysis of Texas property law, see *Sellers v. Harris County*, 483 S.W.2d 242, 243 (Tex. 1972).

147. *See Texas Equal Access to Justice Found.*, 94 F.3d at 1003.

148. *See id.* at 1004.

149. *See* Phillips v. Washington Legal Found., 521 U.S. 1117 (1997) (granting petition for certiorari).

> the IOLTA program, could [not] earn interest for the client of [sic] lawyer?[150]

In a five-to-four decision, the Supreme Court affirmed the holding of the Fifth Circuit.[151] Chief Justice Rehnquist, writing for the majority, observed that the Constitution protects but does not create property rights and that "the existence of a property interest is determined by reference to 'existing rules or understandings that stem from an independent source such as state law.'"[152] The Court observed that the Texas Supreme Court had expressly adopted the "interest follows principal" maxim adopted in *Sellers v. Harris County*.[153] The Court also relied on a presumption of deference for interpretations of state law by federal judges who are citizens of the state in question, noting that the Fifth Circuit panel that decided *Phillips* contained two native Texans.[154] Accordingly, the Court upheld the Fifth Circuit's conclusion that a property right inhered in the IOLTA context, even when a fund owner could not earn net interest payments.[155] The Court also accepted the WLF's argument that the right to exclude others from the use of principal deposits was a cognizable property right that attached to IOLTA funds.[156]

In his majority opinion, Chief Justice Rehnquist did not discuss any of the prior federal or state cases that had upheld IOLTA.[157] Nor did the majority reach the question of whether the IOLTA program worked an unconstitutional taking of the property interest, leaving that question to the Fifth Circuit.[158]

In dissent, Justice Souter, writing for four members of the court, protested the abstract exercise of finding a property right without considering whether a taking had occurred:

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150. *Id.*

151. *See* Phillips v. Washington Legal Found., 524 U.S. 156, 172 (1998).

152. *Id.* at 164 (quoting Board of Regents v. Roth, 408 U.S. 564, 577 (1972)).

153. *Id.* at 165–66 (citing Sellers v. Harris County, 483 S.W.2d 242, 243 (Tex. 1972)).

154. *See id.* at 172.

155. *See id.*

156. *See id.* at 170 ("While the interest income at issue here may have no economically realizable value to its owner, possession, control, and disposition are nonetheless valuable rights that inhere in the property.") (citing Hodel v. Irving, 481 U.S. 704, 715 (1987)). The Court reached this conclusion without considering the distinction raised by the First Circuit in *Massachusetts Bar Foundation*, between cases involving a right to exclude others from real property and cases such as this involving a right to exclude others from "intangible" property. *See supra* Part III.B.

157. *See Phillips*, 524 U.S. at 156–72.

158. *See id.* at 172.

> It . . . makes good sense to consider what is property only in connection with what is a compensable taking, an approach to Fifth Amendment analysis that not only would avoid spending time on what might turn out to be an entirely theoretical matter, but would also reduce the risk of placing such undue emphasis on the existence of a generalized property right as to distort the taking and compensation analyses that necessarily follow before the Fifth Amendment's significance can be known.[159]

Justice Souter worried that the Court's abstract determination of property rights might encourage claims in other contexts where the government holds and makes use of the funds of private parties.[160] Justice Breyer, also writing for four, disagreed with the majority's conclusion that IOLTA interest was private property, viewing the IOLTA program as creating interest proceeds where none could exist otherwise.[161]

D. The WLF Attacks Washington State's IOLTA Program

On January 27, 1997, the WLF filed *Washington Legal Foundation v. Legal Foundation of Washington* in the U.S. District Court for the Western District of Washington, raising Fifth and First Amendment challenges to Washington's IOLTA program.[162] The defendants include the Legal Foundation of Washington (LFW), which distributes IOLTA funds, and the members of the Supreme Court of Washington, who oversee the implementation of IOLTA in their role as regulators of the state's legal system.[163] This suit was filed after the Fifth Circuit decision in *Phillips* but before the U.S. Supreme Court had affirmed that decision.

Interestingly, the WLF did not attack Washington's IOLTA program in total but challenged only the provision relating to Limited Practice Officers (LPOs).[164] It is not entirely clear why the WLF did this, but there are indications that it was motivated by the actions of Washington

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159. *Id.* at 173 (Souter, J., dissenting).

160. *See id.* at 178–79 (Souter, J., dissenting).

161. *See id.* at 182 (Breyer, J., dissenting) ("Here, federal law ensured that, in the absence of IOLTA intervention, the client's principal would earn nothing. . . . [The holding in *Webb's*] says little about *this* kind of principal, principal that otherwise is barren.") (emphasis in original).

162. *See* Complaint for Injunctive Relief, Washington Legal Found. v. Legal Found. of Wash., No. C-97-0146C (W.D. Wash. filed Jan. 27, 1997) [hereinafter Complaint].

163. *See id.*

164. For a discussion of the role of LPOs in Washington and their participation in IOLTA, see *supra* Part I.C.1.

State Supreme Court Justice Richard Sanders.[165] Justice Sanders, who joined the Court after adoption of APR 12.1,[166] privately corresponded with members of the state's escrow industry regarding LPOs and the IOLTA program.[167] In March 1996, he wrote to industry members, indicating that the court was reconsidering the LPO component of IOLTA and asking members of the escrow industry for input.[168] He wrote again in May 1996, informing the industry that the court had chosen not to repeal APR 12.1, over his dissent.[169] In its complaint, the WLF discussed these letters as part of the case background.[170] Justice Sanders has since been dismissed by stipulation as a defendant in the case,[171] probably because he agrees that the LPO portion of IOLTA should be abolished.[172]

All parties moved for summary judgment, and on January 30, 1998, before the U.S. Supreme Court ruled in *Phillips*,[173] District Court Judge John Coughenour ruled that the claimants had no cognizable property interest in IOLTA proceeds.[174] Although there was no specific discussion of the plaintiffs' First Amendment claim, the judge indicated that "a property interest is a prerequisite to establishing either a First or Fifth Amendment claim."[175] Rejecting the reasoning of the Fifth Circuit in *Phillips*, Judge Coughenour aligned himself with the analysis from *Cone v. State Bar*, writing, "The Fifth Circuit's reasoning [in *Phillips*] overlooks the fact that in no event can the client-depositors make any net return on the interest accrued in these accounts. Indeed, if the funds were able to make any net return, they would not be subject to the IOLTA

165. *See* Complaint, *supra* note 162, at 12.

166. Washington Admission to Practice Rule 12.1 is the provision that includes the operations of Limited Practice Officers in the IOLTA regime. *See supra* Part I.C.1.

167. *See* Complaint, *supra* note 162, at 12.

168. *See id.*

169. *See id.*

170. *See id.*

171. *See* Washington Legal Found. v. Legal Found. of Wash., No. C-97-0146C (W.D. Wash. May 15, 1997) (stipulation and order of dismissal as to Richard B. Sanders, Justice of the Supreme Court of Washington).

172. *See* Complaint, *supra* note 162, at 12.

173. The *Phillips* ruling was issued on June 15, 1998. *See* Phillips v. Washington Legal Found., 524 U.S. 156 (1998).

174. *See* Washington Legal Found. v. Legal Found. of Wash., No. C-97-0146C, at 8 (W.D. Wash. Jan. 30, 1998) (order granting defendants' motion for summary judgment).

175. *Id.* at 5.

program."[176] Having concluded that no property right existed, Judge Coughenour granted summary judgment for the defendants.[177]

The WLF appealed this decision to the Court of Appeals for the Ninth Circuit, and that decision is currently pending. The U.S. Supreme Court has since ruled in *Phillips*. In this newly unsettled landscape, the Ninth Circuit ruling will be the next significant signpost for IOLTA case law.

III. WASHINGTON'S IOLTA PROGRAM DOES NOT VIOLATE THE FIFTH OR FIRST AMENDMENT

The Ninth Circuit should look to Washington property law and hold that in Washington, IOLTA proceeds do not constitute private property for the purposes of Fifth or First Amendment analysis. Alternatively, the court should recognize that, under regulatory takings analysis, IOLTA does not effect a taking. The court should also hold that Washington's IOLTA program does not impermissibly burden the First Amendment right not to associate.

A. There Is No Property Interest Implicated by IOLTA in Washington

The Ninth Circuit should affirm Judge Coughenour's decision and hold that under Washington law, IOLTA proceeds do not constitute private property for the purpose of takings analysis. The holding in *Phillips* applied Texas property law but cannot be extrapolated to define the law of property in any other state. Therefore, the Ninth Circuit is not bound by the definition of property delineated in *Phillips*. The court must look to Washington law and its interpretation by Washington courts to determine the definition of property as it applies in this case.

In *Phillips*, the Supreme Court clarified that the existence of a property interest is determined by extrinsic sources such as state law.[178] Evaluating Texas property law, the Court pointed out that a Texas state court case, *Sellers v. Harris County*, had independently established that the Texas Supreme Court followed the "interest follows principal"

176. *See id.* at 7.

177. *See id.* at 9.

178. *See Phillips*, 524 U.S. at 164 (1998) (citing Board of Regents v. Roth, 408 U.S. 564, 577 (1972)). Although the Court made clear that a "[s]tate may not sidestep the Takings Clause by disavowing traditional property interests long recognized under state law," the definition of these "traditional property interests" is also ascertained by reference to state law. *Id.* at 165–66 (citing Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1029 (1992)) (other citations omitted).

maxim established in the *Webb's* case.[179] Under this maxim, the proceeds from Texas' IOLTA program constituted property for Fifth Amendment purposes.[180] The *Phillips* decision was made in reference to state property law, which is the appropriate focus in determining the definition of property for takings clause purposes.[181]

The Ninth Circuit should look to the Supreme Court of Washington to ascertain the definition of property in Washington. State supreme courts are the highest interpretive authorities on issues of state law.[182] In its 1984 IOLTA rule-making opinion, the Supreme Court of Washington directly considered whether Washington adheres to the "interest follows principal" maxim from *Webb's* and concluded that in the IOLTA context, Washington does not.[183] The rule-making opinion dramatically distinguishes *Washington Legal Foundation* from *Phillips,* because the Texas Supreme Court did not issue such a statement on Texas property law when it adopted IOLTA in 1984.[184]

Also, the U.S. Supreme Court has identified a presumption of deference for interpretations of state law by federal judges who are citizens of the state in question.[185] This presumption, which applies to district and circuit court judges, was cited with approval in *Phillips* as a reason for upholding the findings of the Fifth Circuit panel.[186] Judge Coughenour's interpretation of Washington law is due this same presumption of deference.[187] He is a resident of the state of Washington and a member of the Washington Bar.[188] His Order, which is consistent with the rule-making opinion of the Supreme Court of Washington, should guide the Ninth Circuit in interpreting Washington property law.

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179. *See id.* at 165–66 (citing Sellers v. Harris County, 483 S.W.2d 242, 243 (Tex. 1972)).

180. *See id.* at 172.

181. *See id.*

182. *See* Wainright v. Goode, 464 U.S. 78, 84 (1983) ("[T]he views of the State's highest court with respect to state law are binding on the federal courts.").

183. *See* IOLTA Adoption Order, *supra* note 38, at 1108–09.

184. *See* Brennan J. Torregrossa, Note, Washington Legal Foundation v. Texas Equal Access to Justice Foundation: *Is There an IOTA of Property Interest in IOLTA?*, 42 Vill. L. Rev. 189, 201 n.55 (1997).

185. *See* Bernhard v. Polygraphic Co. of Am., 350 U.S. 198, 204 (1956); *see also supra* note 154 and accompanying text.

186. *See Phillips*, 524 U.S. at 167.

187. *See Bernhard*, 350 U.S. at 204.

188. *See* 1 Aspen Law & Bus., *Almanac of the Federal Judiciary* 204–05 (1999).

The Ninth Circuit's recent holding in *Schneider v. California Department of Corrections*[189] does not alter this conclusion. In *Schneider*, state prisoners filed a takings clause challenge to a California statute that created interest-bearing trust accounts for inmates and diverted the interest proceeds to the Inmate Welfare Fund.[190] The Ninth Circuit panel concluded that the "interest follows principal" rule was firmly established within the core meaning of property such that a state could not appropriate interest by statute without triggering takings clause analysis.[191] Citing *Phillips*, the panel ruled that state law could not re-characterize property in opposition to this core meaning.[192] In this regard, the Ninth Circuit went further than the U.S. Supreme Court, which specifically looked to sources of state law in the ruling in *Phillips*.[193]

Schneider is distinguishable from the Washington IOLTA case because of its reliance on California property law. In *Schneider*, the Ninth Circuit thought it significant that California courts had expressly adopted the "interest follows principal" maxim as a tenet of state property law.[194] As discussed above, the Supreme Court of Washington has specifically rejected blanket adoption of the "interest follows principal" maxim.[195]

Further, if the Ninth Circuit meant to conclude that all interest earned on all funds in all cases creates a cognizable property right, the court should reconsider this conclusion in the IOLTA context. There are other situations where state action interferes with interest proceeds. For example, in Washington, state statutes require the use of designated trust funds for real estate brokers[196] and county court litigants.[197] The Ninth Circuit should narrowly construe its holding in *Schneider*, lest it establish an immutable constitutional definition of property that will result in

189. 151 F.3d 1194 (9th Cir. 1998).

190. *See id.* at 1195.

191. *See id.* at 1201.

192. *See id.* at 1200.

193. *See* Phillips v. Washington Legal Found., 524 U.S. 156, 165–67 (1998) (citing Sellers v. Harris County, 483 S.W.2d 242, 243 (Tex. 1972)).

194. *See Schneider*, 151 F.3d at 1201 ("The 'interest follows principal' rule's common law pedigree, and near-universal endorsement by American courts—including California's—leave us with little doubt that the interest income of the sort at issue here is sufficiently fundamental that States may not appropriate it without implicating the Takings Clause.") (citations omitted).

195. *See supra* note 183 and accompanying text.

196. *See* Wash. Rev. Code § 18.85.310 (1998).

197. *See* Wash. Rev. Code § 36.48.090 (1998).

incessant federal court challenges to every type of state interference with interest proceeds.

If the Ninth Circuit concludes that IOLTA proceeds do not create a cognizable property interest, it must affirm Judge Coughenour's opinion dismissing the IOLTA suit. If no cognizable property right exists in IOLTA proceeds, then there is no basis on which to sustain a Fifth Amendment challenge to IOLTA.[198]

B. *Per Se Takings Analysis Is Not the Appropriate Legal Standard for Evaluating the Washington IOLTA Case*

Even if the Ninth Circuit concludes that IOLTA proceeds are property for the purposes of takings analysis, the court should conclude that the Limited Practice Officer (LPO) portion of Washington's IOLTA program does not work an unconstitutional taking of that property. To reach this question, the court must first determine whether the IOLTA program should be evaluated as a per se taking or if regulatory takings analysis from *Penn Central Transportation Co. v. City of New York*[199] applies.[200]

Per se takings analysis does not apply to Washington's IOLTA program because per se takings usually involve the physical invasion of property or the destruction of all economically beneficial use of land.[201] In cases involving government interference with money, rather than real property, courts have been reluctant to apply the per se takings doctrine.[202] For example, in *United States v. Sperry Corp.*,[203] the U.S. Supreme Court indicated that the appropriation of money cannot easily be analogized to per se takings cases involving the invasion of real property.[204] The Ninth Circuit relied on this case in *Commercial Builders v. City of Sacramento*[205] to reject the argument that the appropriation of

198. *See* Washington Legal Found. v. Legal Found. of Wash., No. C-97-0146C, at 5 (W.D. Wash. Jan. 30, 1998) (order granting defendant's motion for summary judgment).

199. 438 U.S. 104 (1978).

200. For a discussion of *Penn Central*, see *supra* Part II.A.

201. *See, e.g.*, Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1015–16 (1992); Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982) (determining when physical occupation of property has occurred).

202. *See, e.g.*, United States v. Sperry Corp., 493 U.S. 52, 62 n.9 (1989).

203. 493 U.S. 52 (1989).

204. *See id.*

205. 941 F.2d 872 (9th Cir. 1991).

money, as a fee, could be analyzed using the per se takings doctrine because unlike real property, money is fungible.[206] Other circuit courts have recognized this same distinction.[207] The U.S. Supreme Court has held that even an individual appropriation of millions of dollars could not be evaluated as a per se taking because there was no permanent physical invasion of property as contemplated by per se takings analysis.[208]

The LPO portion of Washington's IOLTA program does not invade property enough to invoke per se takings doctrine. IOLTA aggregates interest from small or short-term client deposits.[209] The interest earned on any one deposit is minimal.[210] The appropriation applies only to the interest earned and does not affect principal funds in any way. Furthermore, the IOLTA depositor has no reasonable expectation of receiving those interest payments in the absence of IOLTA.[211] As with the appropriation of millions of dollars,[212] the appropriation of small IOLTA payments must also lie outside per se takings analysis.

Key precedents in IOLTA caselaw have indicated that regulatory takings analysis is the appropriate standard for evaluating IOLTA. In *Webb's*, which established the maxim that "interest follows principal," the U.S. Supreme Court cited to *Penn Central* in concluding that the Florida statute was unconstitutional.[213] Also, the four dissenters in *Phillips*, the only justices to engage the takings question, agreed that regulatory takings analysis under *Penn Central* was the appropriate inquiry for IOLTA.[214]

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206. *See id.* at 875.

207. *See, e.g.*, Branch v. United States, 69 F.3d 1571, 1576 (Fed. Cir. 1995); Nixon v. United States, 978 F.2d 1269, 1284–85 (D.C. Cir. 1992).

208. *See* Eastern Enter. v. Apfel, 524 U.S 498, 517, 522–23 (1998) (holding that millions of dollars in statutorily required payments could not be analyzed as per se taking).

209. *See* Wash. Rules of Professional Conduct Rule 1.14(b)(3) (1999).

210. Recall that the Florida lawsuit involved interest proceeds of $2.25. *See* Cone v. State Bar, 819 F.2d 1002, 1004 (11th Cir. 1987).

211. *See* IOLTA Adoption Order, *supra* note 38, at 1101.

212. *See Eastern Enter.*, 524 U.S. at 517, 522–23.

213. *See* Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 163 (1980) ("This Court has been permissive in upholding governmental action that may deny the property owner of some beneficial use of his property or that may restrict the owner's full exploitation of the property, if such public action is justified as promoting the general welfare.") (citing Penn Central Transp. v. City of New York, 438 U.S. 104, 125–29 (1978)) (other citations omitted).

214. *See* Phillips v. Washington Legal Found., 524 U.S. 156, 176 (1998) (Souter, J., dissenting) ("[A]pplication of *Penn Central* would not bode well for claimants like respondents.").

In *Massachusetts Bar Foundation*, the First Circuit explicitly weighed the *Penn Central* regulatory takings factors in analyzing IOLTA, balancing these factors to reject the argument that IOLTA effected a taking.[215] The First Circuit considered the takings question under the assumption that IOLTA did interfere with some cognizable property right.[216] To date, it is the only circuit court to have directly considered the takings issue, and its analysis was not overturned by the limited holding of the Supreme Court in *Phillips*.[217]

C. *Under Regulatory Takings Analysis, Washington's IOLTA Regime Does Not Constitute a Taking of Private Property*

Even if there is a property interest, regulatory takings analysis is the appropriate standard for evaluating the WLF's takings claim against Washington's IOLTA program. Regulatory takings analysis is applied when government regulation affects private property but does not deprive the property owner of all beneficial use of that property.[218] Three factors are generally applied in regulatory takings analysis: (1) the economic impact on the takings claimant, (2) the investment-backed expectations of the property owner, and (3) the nature of the government action.[219]

Weighing these factors to obtain a just outcome, Washington's IOLTA program does not effect an unconstitutional taking of private property.[220] Concerning the first factor, there is no identifiable economic impact on LPOs or their clients from IOLTA. Washington's IOLTA rule requires that LPO client funds that are capable of earning a positive return of interest be excluded from IOLTA.[221] The direct economic impact on LPOs and their clients is therefore nil. Although the U.S. Supreme Court recognized the right to possession and control of IOLTA interest proceeds as a property right,[222] this is an intangible right without

215. *See* Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962, 976 (1st Cir. 1993).

216. *See id.* at 974.

217. *See Phillips*, 524 U.S. at 172 (holding that IOLTA proceeds are property but expressing no view as to whether IOLTA represents taking).

218. *See, e.g.*, Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978).

219. *See id.* at 124.

220. *See supra* Part II.A.

221. *See* Wash. Admission to Practice Rule 12.1(c)(3)(i)–(iii).

222. *See Phillips*, 524 U.S. at 170.

a direct economic component.[223] The removal of this "thin strand [from] the commonly recognized bundle of property rights" is of minimal impact to depositors.[224]

Likewise, IOLTA depositors have no investment-backed expectations from IOLTA deposits. Depositors would not expect to earn interest on IOLTA-sized deposits, even if IOLTA were abolished outright.[225] The funds are not deposited for the purposes of earning interest on an investment; they are deposited to facilitate legal transactions.

The third factor of regulatory takings analysis concerns the nature of the government action.[226] This factor is included in takings analysis to allow governments significant leeway to burden property when exercising the government function.[227] Regulatory takings cases have recognized that when a regulation is designed to promote the common good, the government and social interests are a strong counterbalance to Fifth Amendment protections for property owners.[228] Government could not function otherwise.[229]

Especially because Washington's IOLTA program, as a government action, has such beneficial effect on society, it does not effect a taking. At its core, Washington's IOLTA program is designed as an "adjust[ment of the] benefits and burdens of economic life to promote the common good."[230] The IOLTA program takes advantage of banking laws to aggregate small interest payments that previously devolved to banks, using these funds to finance essential legal services programs. Because the social need for such programs is clear, Washington's IOLTA program supports an important public good. Under regulatory takings analysis, the Ninth Circuit should reject the WLF's Fifth Amendment challenge to Washington's IOLTA program.

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223. *See* Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962, 974 n.10 (1st Cir. 1993).

224. *Id.* at 976.

225. If that were to happen, the interest proceeds would again revert to the banks holding the deposits, providing them with unearned windfall profits. *See supra* Part I.B.

226. *See* Penn Central Transp. Co. v. City of New York, 438 U.S. 104, 124 (1978).

227. *See, e.g.*, Pennsylvania Coal v. Mahon, 260 U.S. 393, 413 (1922) (indicating that government would be unable to function if every burden on private property required compensation).

228. *See, e.g.*, *Penn Central*, 438 U.S. at 124.

229. *See Pennsylvania Coal*, 260 U.S. at 413.

230. *Penn Central*, 438 U.S. at 124.

D. *Washington's IOLTA Program Does Not Violate the First Amendment Right to Freedom of Association*

The government speech doctrine protects Washington's IOLTA program from First Amendment challenge. The government speech doctrine removes the First Amendment limits on compelled financial support discussed in the bar association and labor union cases[231] when government agencies act in a governmental capacity.[232]

The Supreme Court of Washington should be considered a government agency for the purposes of First Amendment analysis. In *Keller*, the U.S. Supreme Court suggested that a state supreme court engages in functions sufficiently governmental to meet the requirements of the government speech doctrine.[233] A state supreme court acts in the arena of public policy because it sets policy for the legal profession.[234]

The Supreme Court of Washington created IOLTA through the Rules of Professional Conduct and the Admission to Practice Rules for LPOs.[235] By controlling lawyer discipline and rule revision, the court continues to exert controlling authority over IOLTA.[236] The WLF acknowledged the controlling role of the Supreme Court of Washington by naming the justices of that court as defendants in the Washington suit.[237] Through IOLTA, the Supreme Court of Washington acted to help provide legal services for low-income people. It is government acting as government, and the ideological opposition of individual IOLTA depositors cannot create a legitimate First Amendment dispute over the program.

Even if the Ninth Circuit does not uphold Washington's IOLTA program under the government speech doctrine, the IOLTA program does not otherwise implicate the First Amendment right not to associate

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231. *See supra* Part II.B.

232. *See* Keller v. State Bar, 496 U.S. 1, 12–13 (1990).

233. *See id.* at 11–12 ("The State Bar does not admit anyone to the practice of law, it does not finally disbar or suspend anyone, and it does not ultimately establish ethical codes of conduct. All of those functions are reserved by California law to the State Supreme Court.").

234. *See id.*

235. *See* Wash. Rules of Professional Conduct Rule 1.14 (1999); *see also* Wash. Admission to Practice Rules 12(h), 12.1 (1999).

236. *See* Wash. Rev. Code § 2.48.060 (1998) (granting Supreme Court of Washington final rule-making authority); *see also* Wash. General Rule 9 (1999) (outlining rule-making procedure).

237. *See* Complaint, *supra* note 162.

discussed in the bar association and labor union cases.[238] This right is implicated when a dissenting member is forced, through financial support and otherwise, to associate with an organization that engages in unrelated ideological activities.[239] The relationship between the dissenter and the organization must consist of more than just limited financial support.[240] It must create a situation in which the dissenter cannot disavow the message of the organization.[241]

No such relationship exists between LPOs, their clients, and the activities of Washington's IOLTA program. Individual IOLTA depositors are not required to affirm or participate in IOLTA activities in any way.[242] The IOLTA program does not even have access to the names of individual depositors.[243] Therefore, there is no risk that IOLTA depositors could be personally associated with the activities of IOLTA. Also, the financial contributions are in effect zero, because the interest payments that are donated to IOLTA would not accrue to LPOs or their clients even if IOLTA were abolished. Therefore, there is an insufficient compelled relationship to invoke the First Amendment right of refusal to associate.[244]

Should the Ninth Circuit rule that the activities of Washington's IOLTA program have ideological content, compelled financial support for these activities is justified by the state's need to improve the quality of legal services for the poor.[245] In *Keller*, the Supreme Court indicated that compelled support of bar association activities is permitted when these activities are necessary to regulate the legal profession or improve the legal services available to citizens.[246] IOLTA seeks to improve the quality of the legal profession by providing access to justice for the low-income citizens of Washington. This mission fits squarely within the scope of permissible activity outlined by the Supreme Court in *Keller*.[247]

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238. *See, e.g.*, *Keller*, 496 U.S. 1; *see also supra* Part II.B.

239. *See supra* Part II.B; *see also* Washington Legal Found. v. Massachusetts Bar Found., 993 F.2d 962, 979–80 (1st Cir. 1993).

240. *See Massachusetts Bar Found.*, 993 F.2d at 979–80.

241. *See id.*

242. *See id.* at 980.

243. Telephone Interview with Barbara Clark, Executive Director, Legal Foundation of Washington (Aug. 18, 1999).

244. *See Massachusetts Bar Found.*, 993 F.2d at 980.

245. *See supra* Part II.B; *see also* Keller v. State Bar, 496 U.S. 1, 14 (1990).

246. *See Keller*, 496 U.S. at 14 (citing Lathrop v. Donahue, 367 U.S. 820, 843 (1961)).

247. *See id.* at 13–14.

Further, there is no basis for concluding that, through Washington's IOLTA program, the Legal Foundation of Washington or the Supreme Court of Washington is engaged in ideologically driven expression. The U.S. Supreme Court has indicated that it is difficult to discern between activities that are expressive and those that are not.[248] At the most extreme, expressive activities can include direct political advocacy, such as endorsement of gun control or nuclear weapons freeze initiatives.[249] IOLTA does not fund such activities. The Foundation funds direct service programs that provide legal advocacy to Washington citizens who would be otherwise unable to afford representation.[250] Although the WLF and other plaintiffs may oppose such efforts, these services fulfill a needed government function. They are not expression.

If the Ninth Circuit views the activities of Washington's IOLTA program as expression, that expression is not sufficiently ideological to support the WLF's First Amendment claim. To trigger First Amendment scrutiny in cases involving compelled financial support, an organization's activities must have ideological content and must be unrelated to advancing the goals of the organization.[251] IOLTA meets neither criterion. Its activities are service based, not ideological, and these activities are tied directly to the legitimate goal of improving the quality of justice.[252] The WLF's view that such activities are impermissibly ideological would subvert the important distinction that the U.S. Supreme Court identified between political and nonpolitical expression.[253] Not all activities are political, and the WLF cannot render IOLTA's activities political simply by asserting a personal objection to them.

Finally, even if the Ninth Circuit views Washington's IOLTA program as an infringement on First Amendment rights, the infringement is justified by a compelling state interest in improving the quality of legal services for the poor. The state may regulate First Amendment rights when the regulation is narrowly tailored to serve a compelling state

248. *See id.* at 15–16.

249. *See id.*

250. *See supra* Part I.C.2.

251. *See Keller*, 496 U.S. at 15.

252. *See, e.g.*, Lathrop v. Donahue, 367 U.S. 820, 843 (1961).

253. *See Keller*, 496 U.S. at 15–16 (discussing distinction between activities related to regulation of legal profession and activities of "political or ideological coloration which are not reasonably related to the advancement of such goals").

interest.[254] Washington's IOLTA program was created to serve the compelling need for improved legal services for poor people. Because individual depositors could not receive IOLTA proceeds in the absence of IOLTA, any burden on them is small and narrowly tailored. If IOLTA does implicate the First Amendment, it does so in a targeted manner and for a good reason. Any First Amendment infringement is therefore permissible.

E. Impacts and Implications of the Phillips *Decision*

The *Phillips* decision, although it did not resolve the ultimate issues raised by the IOLTA suits, has already damaged the legal services system in Washington and around the country. Understandably, it has degraded the morale of those who work providing civil legal services to the poor.[255] These people work under tight budgetary and salary constraints to provide a basic modicum of services to growing numbers of underrepresented people. These advocates now face the prospect of years of protracted legal battles to preserve the existence of a system that is already inadequately funded. By failing to consider the larger implications of its decision in *Phillips*, the Court chose to bog down legal services over a constitutional abstraction. The advocates who work tirelessly in this field rightly perceive the U.S. Supreme Court's decision as a stinging rebuke.[256]

The *Phillips* ruling is especially disheartening because IOLTA supporters understand that the WLF's attempt to undo IOLTA is politically motivated.[257] The WLF sues because it ideologically objects to the activities of some IOLTA-funded programs, including programs that provide civil legal services to refugees seeking political asylum in

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254. *See supra* Part II.B; *see also* Austin v. Michigan Chamber of Commerce, 494 U.S. 652, 657 (1990).

255. *See* Deford, *supra* note 33, at 287.

256. Deford states:

> For poverty law advocates the 1997–1998 term of the Supreme Court will probably be remembered above all for the Court's troubling decision in *Phillips v. Washington Legal Foundation*. Confronted by dramatic cuts in congressional funding for legal services, programs have relied on IOLTA funding as a financial bulwark against the further erosion of client access to equal justice.

Id.

257. The WLF expressly acknowledges that it uses litigation to try to shape public policy along conservative lines. *See* Washington Legal Found., *supra* note 123.

America.[258] In their political opposition to these programs, the WLF seeks to dismantle completely the operations of IOLTA. The professionals who work under difficult circumstances to provide legal services to the poor are justified in seeing the WLF as the proverbial "dog in the manger."[259]

The *Phillips* ruling will have other impacts. It will likely produce other constitutional challenges to IOLTA in numerous jurisdictions.[260] Also, programs that are now voluntary, or that have opt-out provisions, are likely to see funding decline as attorneys become more reluctant to place funds into IOLTA accounts for fear of legal challenges.[261] The current movement of states to shift from voluntary to mandatory programs may cease until the IOLTA challenge is resolved.[262] The result may be a significant decrease in funding for IOLTA, which will disrupt legal services programs that already struggle under cuts from other public funding sources.[263]

V. CONCLUSION

The WLF has led a concerted, eight-year assault on IOLTA in the federal courts. This campaign could eliminate one of the cornerstones of the legal services system in America. The U.S. Supreme Court has given new impetus to this attack through its unfortunate decision in *Phillips*. However, neither the law nor justice supports IOLTA opponents. Ultimately, the IOLTA cases, including the Washington suit, should resolve in favor of IOLTA programs.

The Ninth Circuit has an opportunity to affirm the constitutionality, and the importance, of Washington's IOLTA program. The court should rule that the IOLTA program does not implicate property rights and affirm the decision of Judge Coughenour. Alternatively, the court should reject, on the merits, the Fifth and First Amendment challenges to this essential program. Any other result would spell disaster for the legal rights of low-income Washington citizens.

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258. *See, e.g.*, Washington Legal Found. v. Texas Equal Access to Justice Found., 94 F.3d 996, 998 (5th Cir. 1996).

259. The dog in the manger jealously guards the hay. He cannot eat the hay himself, but will not allow the other animals to eat it either. The application of the story is: "Some begrudge others what they cannot enjoy themselves." Aesop, *Aesop's Fables* 1 (Grosset & Dunlap eds., 1947).

260. *See* Torregrossa, *supra* note 184, at 219.

261. *See id.* at 220.

262. *See id.*

263. *See id.*